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No. 72-442

In the

Supreme Court of the United States

OCTOBER TERM, 1972

J. J. LOWENTHAL, ET AL., A CLASS OF INTERVENING DEFENDANTS,

Petitioners,

v.

ALEXANDER TCHEREPNIN, ET AL., AND THE CLASS FOR WHOM THEY ARE THE NAMED PLAINTIFFS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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INDEX

PAGE

Statement of the Case 1

Pertinent History of City Savings Association .. 4

The Categories of Withdrawable Capital Shares of City Savings Association and Amounts Therein at Pertinent Times 5

The Distinction Between the Two Classes of CSA Depositors Involved in This Petition (Petitioners and Respondents) 6

Reasons for Denying the Writ of Certiorari 9

Argument 11

I. The court below did not construe the decision of this Court in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967) so as to create an inequitable preference in the assets of City Savings Association .. 11

II. Petitioners make no showing that the court below departed from the accepted and usual course of judicial proceedings in holding that Petitioners were accorded due process in the trial court 13

III. Petitioners' claims based on their signing of CSA permanent proxies affords them no right to relief under the Securities Exchange Act of 1934 nor do those claims constitute grounds for granting the writ 15

IV. Petitioners' reliance on *J. I. Case* v. *Borak*, 377 U.S. 426 (1964) and *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) is misplaced. Neither of those cases is apposite here 16

V. Petitioners' attack on the sufficiency of the complaint and the trial court's jurisdiction to enter judgment in this cause is meritless and does not deserve further attention from this Court 17

Conclusion 18

PAGE

Table Of Authorities

Cases

J. I. Case v. Borak, 377 U.S. 426 (1964) 16

Mensik v. Smith, 18 Ill. 2d 572 (1960) 4

Mills v. Electric Auto-Lite Co., 396 U.S. 375 16

Tcherepnin v. Franz, 461 F.2d 544 .....9, 11, 13, 14, 15, 16

Tcherepnin v. Knight, 389 U.S. 332 (1967) 2, 11, 12

Statutes and Regulations

15 U.S.C.A. §78c(a)(10) 2

15 U.S.C.A. §78j(b) 1, 12, 16

15 U.S.C.A. §78cc(b) 1, 3

S.H.A., Ch. 32, §762, Section 4-2 of the Illinois Savings and Loan Act 5

S.H.A., Ch. 32, §773(b), Section 4-13(b) of the Illinois Savings and Loan Act 6, 7, 8

S.H.A., Ch. 32, §773(h), Section 4-13(h) of the Illinois Savings and Loan Act 7, 8

S.H.A., Ch. 32, §848, Section 7-8 of the Illinois Savings and Loan Act 4

S.H.A., Ch. 32, §901, Section 9-1 of the Illinois Savings and Loan Act 5

Rule 19 of the Supreme Court of the United States 9

Fed. Rules Civ. Proc., rule 23(c), 28 U.S.C.A. 2, 8

Rule 10b-5 of the Securities & Exchange Commission (17 C.F.R. 240, 10b-5) 1, 12, 16

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STATEMENT OF THE CASE

The action below to which the petition for a writ of certiorari relates was brought on July 24, 1964 pursuant to Sections 10(b) and 29(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. §§78j(b) and 78cc(b)) and Rule 10b-5 promulgated thereunder (17 C.F.R. 240, 10b-5), (hereinafter the "1934 Act"). Respondents, investors in capital shares of City Savings Association (hereinafter CSA), sued on their own behalf and as a class action

on behalf of over 5,000 investors similarly situated who purchased such shares between July 9, 1959 and June 26, 1964. The action sought rescission of their purchases and recovery of the purchase prices paid by them for their shares of CSA which Respondents alleged those investors had been induced to purchase by materially false and misleading statements, and omissions to state material facts, in violation of anti-fraud provisions of the 1934 Act (A. 10-24).[1] included as defendants were CSA, certain of its officers and certain officials of the State of Illinois.

Respondents and their class are defined by order entered by the District Court pursuant to Fed. Rules Civ. Proc., rule 23(c), 28 U.S.C.A. as depositors in CSA who first opened their accounts on or after July 9, 1959. Petitioners here are a class of intervening defendants defined as depositors in CSA who opened any account there prior to July 9, 1959. Petitioners' class consists largely of those persons originally represented by the 100-Cents-on-the-Dollar Committee which earlier in this case was permitted to intervene only as a party-defendant (A. 28, 29). They answered Respondents' complaint by denying the commission of frauds alleged therein and, together with the named defendants in the complaints, sought dismissal of Respondents' action on grounds of lack of federal jurisdiction. That position was rejected by this Court at the threshold of this action *sub nom.*, *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967).

The present petition for a writ of certiorari is directed to the decision below affirming the District Court's judg-

[1] This Court in *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967) held Respondents' investments to be securities within the meaning of Section 3(a)(100) of the 1934 Act.

ment in Respondents' favor. That court found specifically that only Respondents and their class had properly pleaded a claim under the Federal Securities laws and that they, as persons who purchased CSA securities for the first time after July 9, 1959, had been defrauded in violation of the anti-fraud provisions of the 1934 Act (A. 46-48.)[2] The fraud was found to have arisen by reason of certain fraudulent misrepresentations, misstatements, and omissions to state material facts in connection with the purchase by Respondents and their class of CSA securities, all those frauds occurring after July 9, 1959. (A. 47, 48). As defrauded purchasers, Respondents and their class were granted rescission of their purchase transactions pursuant to Section 29(b) of the 1934 Act (15 U.S.C.A. §78cc(b)). (A. 48, 49). As a result of this rescission, Respondents and their class became judgment creditors of CSA and thus entitled to priority in the distribution of the proceeds of liquidation of CSA by its Receivers, before its remaining depositors who continue as shareholders rather than creditors (A. 48, 49).

The appeal of that order to the court below was unique in that CSA and the other defendants charged with fraud in the complaint did not appeal. Further, the contentions made in the court below and here by Petitioners disclose that they too do not in any meaningful way contest the District Court's Finding of Facts as to the actual frauds committed on Respondents and their class as alleged in the complaint. Instead, Petitioners again attempt to argue, although they have never so pleaded, that they too were

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[2] In referring to the record before this Court, Respondents follow the same procedure described by Petitioners in the footnote appearing at page 11 of their petition. Further, references to the petition for a writ of certiorari will be Ptn., p. ——.

defrauded, that there is but one class of depositors-shareholders and hence that the claims of Respondents and their class should not be preferred (Ptn., pp. 18, 24). As hereinafter shown, that argument is without enough substance to warrant the granting of the petition for certiorari.

Pertinent History of City Savings Association.

CSA was chartered originally by the State of Illinois on February 28, 1908 under a different name. In 1943, it adopted its present name.

On April 25, 1957 the Auditor of Public Accounts of the State of Illinois took custody of CSA and suspended payments to depositors.

Pursuant to a decree entered by the Circuit Court of Cook County, Illinois on December 6, 1957, custody of CSA was restored to its officers and directors on December 14, 1957. It was reopened to the public on December 19, 1957 but on a limited withdrawal rotation basis as to its then existent accounts on which basis it continued until it was again closed by State seizure in June, 1964.

On February 3, 1959, the Circuit Court of Cook County, Illinois entered a final decree adopting the findings and conclusions of the December 6, 1957 decree and terminating jurisdiction of that court over CSA, including the requirement of periodic reports to that court.

On January 22, 1960 the Supreme Court of Illinois affirmed the decree returning custody of CSA to its management (*Mensik* v. *Smith*, 18 Ill.2d 572, (1960)).

On June 26, 1964, the Director of Financial Institutions of the State of Illinois took custody of CSA pursuant to Section 7-8 of the Illinois Savings and Loan Act (S.H.A., Ch. 32, §848) (hereinafter "the Illinois Act") once again.

On June 30, 1964, CSA was closed by the Director of Financial Institutions.

From June 26, 1964 to September 11, 1964, CSA was in the custody of the State of Illinois, acting through the Director.

From September 11, 1964 to September 19, 1968, CSA was in the custody of three liquidators under a plan of so-called voluntary liquidation purportedly adopted under Article 9-1 *et seq.* of the Illinois Act (S.H.A., Ch. 32, §901 *et seq.*).

On September 7, 1968, two federal receivers were appointed by the District Court, who on September 19, 1968 took custody of CSA and have since managed its assets.

The Categories of Withdrawable Capital Shares of City Savings Association and Amounts Therein at Pertinent Times.

CSA had established seven categories or types of withdrawable capital share accounts, four of which were in being long prior to 1959 pursuant to express authorization by Section 4-2 of the Illinois Act (S.H.A., Ch. 32, §762), and three of which were established after July 9, 1959. The pre-July 9, 1959 share accounts were: (1) Optional Shares; (2) Paid-Up Shares; (3) Pre-Paid Shares; and (4) Installment Serial Shares.

The post-July 9, 1959 accounts were: (5) Christmas Club; (6) Investment Shares—Investment Plan; and (7) Investment Shares—Thrift Plan.

With insignificant dollar-amount variations, the first four categories are capital share accounts actually opened by Petitioners *before* July 9, 1959.

The sixth category, Investment Shares—Investment Plan, represents accounts opened by Petitioners long prior to July 9, 1959 but thereafter converted by them into this category, without parting with any new money.

Virtually all accounts first opened after July 9, 1959 and therefore the accounts of Respondents and their class are in the seventh category, Investment Shares—Thrift Plan.

The Distinction Between the Two Classes of CSA Depositors Involved in This Petition (Petitioners and Respondents).

Almost immediately after CSA's custody was restored to its officers and directors by the decree of the Circuit Court of Cook County, Illinois entered on December 6, 1957, CSA, by resolution of its board of directors, imposed limitations on the amounts which its depositors could withdraw within any specified period and placed all its then depositors (Petitioners here) on a rotation withdrawal system. (CSA minutes of December 14, 1957.)[1] In so doing, CSA acted under the provisions of Section 4-13(b) of the Illinois Act (S.H.A., Ch. 32, §773(b)), providing that "if the association has insufficient funds in the treasury and from current receipts to pay all matured accounts and applications for withdrawal, within thirty days after such accounts mature or payment is requested, then the board of directors shall provide by resolution" for the operation of the association on a restricted withdrawal and rotation basis.

The resolution of December 14, 1957 also directed CSA's officers to immediately advise its then shareholders (Pe-

[1] These minutes and others hereinafter referred to were before the court below as part of the record on appeal.

titioners) in writing of these restrictions. On the date of this resolution and continuously thereafter until July 9, 1959, CSA had only the four categories of accounts hereinbefore described, all subject to the restrictions on withdrawals and required to be on a rotation basis. They included all then deposits of Petitioners.

From December 14, 1957 until its seizure in June 1964, CSA continued to operate under the withdrawal restrictions of Section 4-13(b) of the Illinois Act as to these Petitioners' share-accounts and from time to time CSA provided for notice to that effect to Petitioners (CSA minutes of December 14, 1957, May 6, 1958, July 1, 1958, December 16, 1958, January 27, 1959, February 17, 1959, June 19, 1959). During that period and thereafter to June 30, 1964, Petitioners were limited to withdrawals not to exceed $200 an account and then only eleven to fourteen months apart under the rotation system (CSA minutes of July 29, 1958, September 2, 1958, September 30, 1958, December 2, 1958, January 6, 1959, January 27, 1959, February 17, 1959, March 31, 1959).

On July 9, 1959, Section 4-13(h) (S.H.A., Ch. 32, §773(h)) of the Illinois Act became effective until its repeal on July 23, 1965. It provided:

> "(h) An association while operating under this Section [Sec. 4-13(b)] may accept additional withdrawable capital from its present shareholders as well as accept new withdrawable capital accounts and such withdrawable capital accounts shall not be subject to the provisions of subsection (b) of this section but shall be subject to withdrawal at will so long as the association is operating under the provisions of subsection (b) of this section."

Shortly thereafter CSA established the three new forms of accounts: Investment Shares—Investment Plan; Invest-

ment Shares—Thrift Plan; and Christmas Club, which under Section 4-13(h) could not be subject to the restrictions of Section 4-13(b). Virtually all accounts opened by Respondents and their class were Investment Shares—Thrift Plan accounts.

Among the most important frauds charged by Respondents and found by the trial court was the omission of CSA to advise them as newcomers to CSA at the time they opened new deposit accounts or made further deposits therein of the fact that CSA was in tight financial straits as to pre-July 9, 1959 depositors (Petitioners) and was operating under Section 4-13(b) as to those accounts (A. 47). That material non-disclosure to new investors (Respondents) was held to be a violation of the anti-fraud provisions of the 1934 Act (A. 48).

Pursuant to Fed. Rules Civ. Proc. rule 23(c), 28 U.S.C.A., the trial court defined and separated the classes here between (a) those who first opened accounts on or after July 9, 1959 (Respondents and their class) and (b) those who opened any account prior to that date (Petitioners) (A. 46). This division was inevitable and incapable because the enactment of Section 4-13(h), effective on July 9, 1959, permitted new types of unrestricted accounts to be opened in CSA by new depositors. Those new depositors had no knowledge of the prior restrictions on pre-July 9, 1959 accounts and no disclosure of this was made to them. Under these circumstances, the District Court quite justifiably held that the pre-July 9, 1959 depositors (Petitioners) constituted a defendant class having an adverse interest to Respondents' class (A. 5).

REASONS FOR DENYING THE WRIT OF CERTIORARI

The concern of this Court over its ever-increasing caseload and the continuous flow of petitions for certiorari is too well known to require discussion. As it is, that load continues to increase because, among other reasons, there are petitions for writs of certiorari which do meet the standards of Rule 19 of this Court setting forth the character of reasons which will be considered here in determining whether to grant the writ. This petition is not one of them.

Here, Petitioners have made no effort whatsoever to comply with Rule 19. Instead of directing their petition to an exposition of why the decision below involves any of the reasons set forth in that Rule for consideration as to whether to grant the writ, Petitioners have presented here nothing more than a jerry-built reargument of the same matters argued by them on the merits in the court below and there rejected. In making that presentation here, Peittioners have not even gone to the trouble of making changes necessary to indicate that the argument is addressed to this Court and not the court below. (See, for example, the headnote to Point I of their Argument.) Their entire discussion is based upon alleged errors in the trial court and there is not a single word in their argument, not even a critical word, dealing with the opinion below holding that there was no such error and affirming the trial court.[4]

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[4] The court below did modify the trial court's judgment by enlarging Respondents' class in certain minor respects. 461 F.2d at 554. This modification was suggested by Respondents in their brief filed in the appeal. The modification is not relevant to the question now before this Court.

In short, the petition is in no way responsive to the decision below as required by Rule 19. Under these circumstances, it appears that Petitioners' failures in this respect calls for denial of the petition almost out-of-hand. Nevertheless, out of an abundance of caution, Respondents, as succinctly as possible, consider the matters briefly referred to by Petitioners on the one page of the petition headed "Reasons For Granting The Writ" (Pta., p. 14).

ARGUMENT

I.

THE COURT BELOW DID NOT CONSTRUE THE DECISION OF THIS COURT IN TCHEREPNIN v. KNIGHT, 389 U.S. 332 (1967) SO AS TO CREATE AN INEQUITABLE PREFERENCE IN THE ASSETS OF CITY SAVINGS ASSOCIATION.

Petitioners claim that the court below has construed this Court's threshold decision in this case *sub nom. Tcherepnin* v. *Knight,* 389 U.S. 332 (1967) so as to create "an inequitable preference in the assets of a defunct savings and loan association for about one-half of the depositors" (Ptn., p. 14). This bald assertion is left to stand by itself and there is no argument made thereafter in its support, undoubtedly for the reason that the opinion below provides absolutely no basis for such argument.

As a matter of fact, the only reference in the body of the opinion below to *Tcherepnin* v. *Knight* is in connection with the comment by the court below by way of *dicta* as to the jurisdictional grounds for Respondents' action under the 1934 Act as found by this Court, 461 F. 2d at 546, 547. That jurisdiction was held in *Knight* to exist because under the circumstances of this case a withdrawable capital share in an Illinois savings and loan association is a "security" within the meaning of the 1934 Act.

The court below by setting forth a quotation from this Court's opinion in *Knight,* 461 F.2d at 547, indicated its express understanding that *Knight* involved only the jurisdictional question and that any questions relating to priority of claims and superiority of rights as between

classes of CSA depositors were irrelevant to the *Knight* decision (See *Knight,* 389 U.S. at 346). There is just nothing in the decision below which indicates any departure from that understanding by the court below.

Because, as pointed out above, Petitioners are not responsive to the reasoning of the court below in support of its decision, it is difficult to meet arguments which are not made. Respondents point out, however, that to the extent Petitioners' point is comprehensible at all, they are contending that because they were still shareholders in CSA (under the decision in *Knight*) when the frauds alleged in Respondents' complaint were committed, Petitioners likewise became entitled to the same rights as Respondents. This is a complete *non-sequitur*. (It was referred to in Respondents' brief in the court below as the "me too" argument.)

Any such contention of Petitioners would have no merit for the following reasons:

1. Respondents' complaint alleging violation of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder was the only complaint ever filed in the trial court. Petitioners, as intervening defendants, resisted the complaint on the merits and denied the fraud allegations therein set forth. Petitioners never filed any appropriate pleading in this proceeding alleging any fraud on them. At the trial, they conceded the frauds alleged by Respondents.

2. Section 10(b) of the 1934 Act and Rule 10b-5 by their express language and court interpretation protect investors only against frauds in connection with "the purchase or sale" of a security. That protection does not extend to frauds subsequent to any purchase or sale and not connected therewith.

3. Petitioners invested their money in CSA long prior to the commission of the frauds alleged and proved by Respondents. Those frauds then had no relation back to Petitioners' purchase of CSA's shares. Petitioners thus had no cause of action under the 1934 Act. On the other hand, the proof at the trial established that the frauds alleged in the complaint directly caused Respondents' purchases of CSA's securities and hence were actionable under the 1934 Act.

4. Petitioners were not without opportunity to sue in the State courts for any post-purchase frauds arising out of waste, mismanagement, breach of fiduciary duty and the like. But they brought no such action.

The decision below both expressly and implicitly, 461 F.2d at 442, relies on these factors as a *ratio decidendi*. None of those factors are discussed by Petitioners.

II.

PETITIONERS MAKE NO SHOWING THAT THE COURT BELOW DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS IN HOLDING THAT PETITIONERS WERE ACCORDED DUE PROCESS IN THE TRIAL COURT.

Petitioners complain that they were excluded by the District Court from participation in the liquidation of CSA's assets without a trial and without "the support of evidence" (Petn., p. 14). They state that by its affirmance of this conduct the Court below has departed from the accepted and usual course of judicial proceedings.

In support of this proposition Petitioners advance the same argument made below critical of the trial court's reliance on the Manual for Complex and Multi-District Litigation and they repeat their assertion that the trial

court by an "indefinite order" admitted evidence in wholesale fashion without foundation or opportunity for them to object (Ptn., p. 16).

The court below decided this point adversely to Petitioners, held they had been accorded due process, and pointed out, among other things, that the procedure utilized by the trial court was proper under the circumstances here and that petitioners had been free under that procedure to offer evidence and to argue the relevance or probative value of any of the evidence admitted. 461 F.2d at 548, 549.

The holding of the court below was based on an examination of the record in the trial court and it referred in detail to those proceedings. Petitioners do not here attempt to meet the decision in this or any other respect. Hence their contention as to the departure of the court below from "accepted and usual course of judicial proceedings" is without merit. This becomes even more evident when it is noted that in its decision, the court below stated, 461 F. 2d at 549:

> "The district court thus outlined for the parties how it intended to handle the case. The transcript shows no response to the court's query by counsel for the pre-July 9, 1959 depositors. *Those investors made no objection to this form of trial procedure. In response to questioning during oral argument, their counsel told this court that they had never offered any evidence nor had they been denied the right to offer evidence. Counsel further informed us that the district court had been willing to review any pertinent evidence that the parties brought to its attention.*" (Emphasis added.)

Petitioners' failure here to even comment on those admissions by them to the court below during the oral argument there effectively demonstrates the untenability (and unworthiness) of their argument here.

III.

PETITIONERS' CLAIMS BASED ON THEIR SIGNING OF CSA PERMANENT PROXIES AFFORDS THEM NO RIGHT TO RELIEF UNDER THE SECURITIES EXCHANGE ACT OF 1934 NOR DO THOSE CLAIMS CONSTITUTE GROUNDS FOR GRANTING THE WRIT.

In their repetition here of the same arguments made on the merits in the court below, Petitioners again argue that they were defrauded by being induced to sign permanent proxies which were utilized by CSA's defendant officers to keep themselves in office and thus perpetuate their power and ability to perform the frauds established in this case (Ptn., pp. 20, 23, 25).

In deciding this contention adversely to Petitioners, the court below stated, 461 F. 2d at 550:

> "Underlying the second argument of the pre-July 9, 1959 depositors is the premise that the use by the named defendants of the permanent proxies to 'perpetuate [their] power and ability to perform frauds, misrepresentations and concealments' is covered by Section 10(b) and Rule 10b-5. Those provisions involve the purchase or sale of a security. The solicitation of proxies or the giving of them or the failure to revoke a proxy is not by itself the purchase or sale of a security. Further, Section 14(a) of the Securities Exchange Act of 1934 and Rule 14(a) thereunder regulating proxy solicitation apply only to securities registered under Section 12 of the Act. Withdrawable shares such as those in CSA are exempt from such registration under Section 12(g)(2)(C) of the Act.

> The intervening defendants-appellants' reliance on Mills v. Electric Auto-Lite Co., 396 U.S. 375, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970) is, therefore, misplaced."

The petition in no way responds to this impeccable holding and attempts no showing as to why this point would fall within the ambit of Rule 19 of this Court.

IV.

PETITIONERS' RELIANCE ON J. I. CASE v. BORAK, 377 U.S. 426 (1964) AND MILLS v. ELECTRIC AUTO-LITE CO., 396 U.S. 375 (1970) IS MISPLACED. NEITHER OF THOSE CASES IS APPOSITE HERE.

Petitioners state that "The District Court has failed to follow two decisions which the Intervening Defendants believe compel a holding that all defrauded depositor-shareholders had void contracts under 15 U.S.C., Section 78cc(b) and should be treated equally under the law." (Ptn., p. 26)[5] The decisions referred to are *J. I. Case* v. *Borak*, 377 U.S. 426 (1964) and *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970).

Each of those cases dealt with alleged violations of Section 14(a) of the 1934 Act and not Section 10(b) of that Act, the section here involved. They do not stand for the proposition for which they are cited. They are inapposite here and the court below so recognized. (461 F.2d at 550.) Petitioners do not comment on this at all.

To the extent that Petitioner urge that *Borak* holds that federal courts may fashion appropriate remedies where

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[5] This reference to the "District Court" again emphasizes Petitioners' failure to find anything to attack in the decision in the court below and again evidences the jerry-built nature of the petition.

federal rights are invaded in violation of a federal statute, Respondents point out that without such violation, obviously no remedy may be so fashioned. Petitioners have never been able to show any violation of their rights under Section 10(b) of the 1934 Act or that they even pleaded such a violation. That Section with Rule 10b-5 promulgated thereunder, is the only federal statute here involved.

V.

PETITIONERS' ATTACK ON THE SUFFICIENCY OF THE COMPLAINT AND THE TRIAL COURT'S JURISDICTION TO ENTER JUDGMENT IN THIS CAUSE IS MERITLESS AND DOES NOT DESERVE FURTHER ATTENTION FROM THIS COURT.

In what is patently a dying grasp at a straw, Petitioners at this last stage of this case argue for the first time that Respondents' complaint did not state a cause of action and that therefore the District Court was without jurisdiction to enter any judgment (Ptn., p. 31).

This absurd stance for granting the writ is based upon the contention that Respondents failed to plead in their rescission action an offer of restitution of the T.V. sets, typewriters, radios, etc. which Petitioners claim Respondents received as "premiums" when they purchased securities in CSA (Ptn., pp. 30, 31). Petitioners urge this Court to decide this question. They do not say why or how this picayune question, even if it were meritorious is important enough to warrant the attention of this Court or how it falls within Rule 19, or why it was never raised below.

Apart from pointing out that Petitioners have never raised this question below and in any event, would have had no standing to do so, Respondents refrain from further answer.

CONCLUSION

For the foregoing reasons, Respondents respectfully submit that the petition for a writ of certiorari be denied.

Respectfully submitted,

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DATED: November 17, 1972